



IN THE SUPREME COURT OF THE STATE OF DELAWARE

EPICENTRX, INC.,

Plaintiff Below-Appellant,

v.

PROTHEX, INC.,

Defendant Below-Appellee.

No. 167, 2023

APPEAL FROM THE
COURT OF CHANCERY OF
THE STATE OF DELAWARE,
C.A. NO. 2021-0724-PAF

APPELLANT'S REPLY BRIEF

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INTRODUCTION

In its Answering Brief (cited as “Ans. Br.”), Defendant-Appellee Prothex, Inc., f/k/a Drais Pharmaceuticals, Inc. (“Defendant” or “Prothex”) simply repeats the Court of Chancery’s factual findings below. While the trial court found correctly that Plaintiff-Appellant EpicentRx, Inc. (“Plaintiff” or “EpicentRx”) had proven a credible basis to establish its stated purpose of investigating mismanagement at Prothex, the trial court nonetheless concluded that this was not Plaintiff’s primary purpose for its Section 220 demand for books and records; and that Plaintiff’s actual primary purpose was improper. However, the record below does not support that decision, which should be reversed.

The Court of Chancery made no credibility determinations and applied the law to undisputed facts,¹ so this Court should review that decision *de novo*. Applying the current law governing Section 220 actions, the Court of Chancery’s ruling is not supported by the undisputed facts below. However, even under a more deferential standard of review, the Court of Chancery’s determination that EpicentRx’s stated purpose was not its primary purpose was clearly erroneous and must be overturned.

¹ EpicentRx’s reference to undisputed facts is not tantamount to a concession that, “the Court of Chancery correctly found that its stated purpose was not its primary purpose,” as Defendant avers in its Answering Brief. Ans. Br., at 3. EpicentRx clearly argues the opposite, and the primary basis for this Appeal is that the trial court misapplied *the law* to the undisputed facts.

The Court of Chancery considered the following facts, which EpicentRx did not dispute, when analyzing whether EpicentRx's stated purpose of investigating mismanagement was not its true purpose. EpicentRx filed two actions in California against Prothex and one of its directors; EpicentRx's representative on Prothex's board of directors did not request the same documents or investigate mismanagement while he was a director; the scope of EpicentRx's initial demand; the timing of the initial demand; and EpicentRx's litigation conduct. None of these facts, however, support a finding that EpicentRx's stated purpose was not its primary purpose, nor do they rise to level of extreme conduct that existed in *State v. United Brokerage Co.*, 101 A. 433 (Del. Super. Ct. 1917), the decades-old case on which the Court of Chancery based its holding. In addition, the Court of Chancery denied EpicentRx access to Prothex's books and records, despite the ample (and undisputed) evidence of Defendant's wrongdoing in the record, such as Prothex's unlawful and undisclosed dissolution in violation of Section 275 of the Delaware General Corporations Law, and Prothex's and its officers' disregard of shareholder interests and mismanagement of the company.

For these reasons, and as stated below and in Plaintiff's Opening Brief, the Court of Chancery's holdings that EpicentRx's stated purpose of investigating mismanagement was not its true purpose, and its true purpose is improper, are erroneous and reversible.

ARGUMENT

In its Opening Brief, EpicentRx explained that (1) the Court of Chancery's holding below misapplied legal precedent to undisputed facts and, therefore, is subject to *de novo* review, and (2) even under a more deferential standard of review, the ruling below was unsupported by the record and the law, and is clearly erroneous. In response, Prothex largely repeats the Court of Chancery's factual findings but does not address the Court of Chancery's error of law or refute the evidence of Prothex's wrongdoing and mismanagement that supported EpicentRx's stated purpose of investigation.

Irrespective of whether this Court applies a *de novo* or abuse of discretion standard of review, Prothex failed to rebut EpicentRx's proof of wrongdoing and mismanagement or meet its substantial burden to prove that EpicentRx's stated purpose was not its true purpose, and its primary purpose was improper.

I. THIS COURT SHOULD APPLY A *DE NOVO* STANDARD OF REVIEW

De novo review is appropriate because the Court of Chancery did not resolve any factual disputes, but rather decided the case on undisputed facts. After holding correctly that EpicentRx had established a proper purpose to inspect books and records, the Court of Chancery then misapplied the relevant legal standard which imposed a significant burden on Prothex to *disprove* EpicentRx's stated purpose.

This Court can and should apply the law to the undisputed facts below and reach a different result.

This Court's holding in *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*, 681 A.2d 1026, 1030 (Del. 1996) (quoting *State ex rel. Scattered Corp. v. Chicago Stock Exch.*, 1996 WL 191023, at *2, reported at 676 A.2d 907 (Del. 1996) (TABLE)), that "[t]he determination of whether [a plaintiff's] stated purpose for the inspection was its primary purpose, is a question of fact warranting deference to the trial court's credibility assessments," is distinguishable. In *Thomas & Betts*, the Court cited *State ex rel. Scattered Corp. v. Chicago Stock Exchange* in applying an abuse of discretion standard to the trial court's determination of whether a stockholder plaintiff's stated purpose is its primary purpose, but *Scattered Corp.* addressed a "writ of mandamus to compel inspection of certain books and records," which is "a separate remedy which does not share entirely the analytical framework of section 220." 1996 WL 191023, at *1, *4. Although under an abuse of discretion standard, the court affirmed the trial court's determination that the plaintiff sought books and records for an improper purpose, it noted that "[i]n the mandamus setting, ... the court is free to consider other factors that may not be relevant to a section 220 action." *Id.*, at *4.

Because *Scattered Corp.* addressed relief other than that available under Section 220, *Thomas & Betts* is inapplicable and the Court should review the Court

of Chancery's holding, in which it applied the law to undisputed facts, *de novo*. Here, the Court of Chancery made no credibility assessments and did not resolve any fact disputes. This appeal does not require this Court to review any factual findings, but rather only to review how the Court of Chancery applied the undisputed facts to the law. Therefore, even if *Thomas & Betts* and *Scattered Corp.* applied in a Section 220 action, the Court of Chancery's findings were purely legal and subject to *de novo* review.

II. **THE FACTS DO NOT SUPPORT THE COURT OF CHANCERY'S RULING**

Even under a more deferential standard of review, the Court of Chancery's ruling was clearly erroneous and should be reversed. First, the Court of Chancery found correctly that EpicentRx met its burden to establish a proper purpose under Section 220 to investigate mismanagement at Prothex (and Prothex does not contest this finding or argue otherwise). Then, the Court of Chancery considered whether Prothex could rebut EpicentRx's stated purpose by proving that it was not EpicentRx's *actual* purpose. The Court of Chancery's holdings that investigating wrongdoing was not EpicentRx's true purpose, and that its actual purpose was improper, are not supported by the record evidence.

The facts in the record that were central to the Court of Chancery's holding – concerning the parties' contractual relationship, the timing of Plaintiff's demand, and Plaintiff's pursuit of litigation against Defendant in other jurisdictions – are not

disputed. Defendant somehow construes EpicentRx's contention – that the pertinent facts were undisputed – as a concession that the Court of Chancery's ruling was correct. Ans. Br., at 3. This is incorrect and belied by the substance of this appeal. The fact that EpicentRx contends that the relevant underlying facts are not disputed and that the Court of Chancery misapplied the relevant law to them are not mutually exclusive. These facts, however, do not support the Court of Chancery's conclusion that EpicentRx's stated purpose was *not* its true purpose and its true purpose was improper. Prothex's arguments that the ruling below correctly applied the law are unavailing.

Prothex incorrectly tries to justify the Court of Chancery's reliance on *State v. United Brokerage Co.*, 101 A. 433 (Del. Super. Ct. 1917) (Ans. Br. at 26-28), but never explains how *United Brokerage*, which predates the adoption of Section 220 and addressed a stockholder's common law right to compel inspection of books and records, is controlling in a Section 220 case like this one and on the facts at issue. Prothex mentions other cases that the Court of Chancery cited (Ans. Br. at 28); however, the trial court cited them only for general statements of the law about determining the propriety of the stockholder's purpose, determining the stockholder's true purpose, and what a proper purpose is. *See* Op. Br., Ex. A at 20:16-20; 21:22-22:8; 24:1-11. Those cases do not support the Court of Chancery's analysis of EpicentRx's true purpose. The Court of Chancery based its holding on

United Brokerage, which does not address the high burdens of proof that Prothex failed to meet under Section 220 and therefore should not apply.

Prothex also argues that the Court of Chancery “correctly” considered facts that are undisputed, but this fails to acknowledge that the sum of these facts do not rationally support the trial court’s conclusions that EpicentRx’s stated purpose was not its true purpose, and its true purpose was improper. For example, Prothex mentions the California actions pursued by EpicentRx (Ans. Br. at 28-31), the fact that EpicentRx’s representative on Prothex’s board of directors of Prothex did not request pertinent investigative documents in his capacity as director or investigate mismanagement on his own (Ans. Br. at 31-33), the scope of books and records requested in EpicentRx’s initial demand (Ans. Br. at 33-34), the timing of EpicentRx’s initial demand (Ans. Br. at 34-35), and EpicentRx’s litigation conduct (Ans. Br. at 35). These are indeed facts in the record below, but combined they do not carry Prothex’s burden to prove that EpicentRx’s stated purpose to investigate mismanagement was not its true purpose, and its true purpose was improper.

Prothex also offers no reasoned basis to support the Court of Chancery’s reliance upon the extreme facts in *United Brokerage*. In *United Brokerage*, a stockholder was denied inspection because he expressly “threat[ened] to exercise his right as a stockholder to inspect the books and records of the company, and use the information gained in such inspection, for the purpose of bringing suits to annoy and

harass the defendant, and to injure its business and the business of its subsidiaries.” 101 A. at 437. Here, the record contains no evidence of any such threat by EpicentRx, that EpicentRx intended to use books and records sought in the inspection to bring suits to annoy and harass Prothex, or that EpicentRx intended to injure Prothex’s business like the stockholder did in *United Brokerage*. Accordingly, the circumstances in *United Brokerage* differed substantially from those in this case, and the Court of Chancery erred by relying upon it.

When comparing evidence of wrongdoing at Prothex to claims that EpicentRx falsely stated its true purpose for inspection, the Court of Chancery also failed to consider other facts in the record. For example, the trial court found that Prothex unlawfully dissolved on November 10, 2021 (with a false statement in its Certificate of Dissolution) without proper authority to do so, and that the dissolution was not “effected in accordance with Section 275,” as “[t]here was no board meeting or director written consent approving a dissolution, and there was no stockholder meeting or stockholder written consent authorizing the dissolution of the company.” Op. Br., Ex. A at 15:3-9. This evidence further proves that EpicentRx’s stated purpose of investigating mismanagement was its true purpose to inspect books and records. It is undisputed that Prothex never informed EpicentRx about the dissolution, and EpicentRx only discovered it in March 2022. *See id.* at 14:19-23; 45:23-46:5. Moreover, Prothex conceded that the “dissolution certificate was

inaccurate and that the dissolution had not been properly effected under Delaware law, [and] the company has failed to take any action to comply with Delaware law.” *Id.* at 46:8-12. These facts all support a credible basis to infer wrongdoing, which is the standard for establishing its purpose of investigating mismanagement for the Section 220 demand. *E.g., Paul v. China MediaExpress Holdings, Inc.*, 2012 WL 28818, at *4 (Del. Ch. Jan. 5, 2012) (“shareholder must present some credible basis through documents, logic, testimony or otherwise from which the Court can infer wrongdoing . . . that would warrant further investigation”). The Court of Chancery did not consider these facts, however, in determining whether EpicentRx’s stated purpose of investigating mismanagement was its true purpose.

In the context of these facts and those undisputed in the trial court, EpicentRx clearly established its proper purpose of investigating mismanagement. Once EpicentRx has met this threshold level of proof, which it did in the Court below, Prothex has a much higher burden when it attempts to show that, first, this purpose was not EpicentRx’s primary purpose; and second, that EpicentRx’s alleged primary purpose was improper. Prothex did not and could not meet this burden, and the Court of Chancery erred when making its finding that Prothex did so. The trial court’s misapplication of the law thus calls for reversal by this Court.

CONCLUSION

Prothex does little more than recite undisputed record facts but fails to acknowledge that the Court of Chancery made no credibility determinations or resolved any fact disputes that would be subject to a deferential standard of review. The Court of Chancery applied the law governing burden shifting in Section 220 actions to those undisputed facts, and this Court should review its application of the law to those facts *de novo*. The Court of Chancery misapplied the law in finding that Prothex satisfied its burden to prove that EpicentRx's stated purpose was not its true purpose and its true purpose is improper and, in any event, the facts in the record do not support that conclusion by the Court of Chancery. Accordingly, EpicentRx respectfully requests that this Court reverse the Court of Chancery's ruling and compel Prothex to allow EpicentRx to inspect all remaining books and records.

Dated: August 25, 2023

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on August 25, 2023, true and correct copies of the foregoing were served upon the following counsel of record via File & ServeXpress:

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